

Message Text

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ACTION EA-09

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TAGS: ECRE, EFIN, OPEC, KS, XF

SUBJECT: SYNDICATION OF U.S. BANK'S STANDBY GUARANTEE FOR
KOREAN MIDDLE EAST CONSTRUCTION PROJECTS

REF: SEOUL 389 (NOTAL) SEOUL A-7 SEOUL (NOTAL)

SUMMARY: EMBASSY HAS BEEN INFORMED BY THE LOCAL FNCB
REP THAT FNCB EFFORTS TO ORGANIZE A SYNDICATION OF U.S.
BANKS TO PROVIDE A \$100 MILLION BACKUP PERFORMANCE
GUARANTEE FOR KOREAN CONSTRUCTION PROJECTS IN THE MIDDLE
EAST ARE GOING VERY WELL. TENTATIVE COMMITMENTS TOTAL
\$85 MILLION AND OVERSUBSCRIPTION OF THE \$100 MILLION
TARGET IS CONSIDERED LIKELY. THE ROKG HAS PLACED A
VERY HIGH PRIORITY ON OBTAINING THIS STANDBY GUARANTEE
AS PART OF ITS EFFORTS TO PROMOTE EXPANSION OF KOREAN
OVERSEAS CONSTRUCTION ACTIVITY. IN RELATED DEVELOPMENTS,
ROKG MINISTER OF CONSTRUCTION ANNOUNCED YESTERDAY THAT
HE NOW EXPECTS KOREAN FIRMS TO TRIPLE THE ORIGINAL GOAL
OF \$1.2 BILLION IN NEW CONTRACTS IN 1976. FOR THE
PRESENT, THE EMBASSY IS INCLINED TO TAKE MINISTER
KIM'S REMARKS WITH A HEALTHY GRAIN OF SALT. SHOULD
HE BE PROVEN CORRECT, IT COULD HAVE IMPORTANT IMPLICATIONS
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FOR THE BALANCE OF PAYMENTS OUTLOOK IN THE RELATIVELY NEAR-

TERM, BUT IT WOULD ALSO RAISE SERIOUS
QUESTIONS AS TO WHETHER KOREAN FIRMS ARE GETTING OVEREXTENDED.
END SUMMARY

1. PHILIP HERMAN, HEAD OF THE SEOUL BRANCH OFFICE
OF FIRST NATIONAL CITY BANK OF NEW YORK (FNCB) HAS
INFORMED THE EMBASSY THAT THE FNCB-ORGANIZED SYNDICATION
OF A \$100 MILLION PERFORMANCE GUARANTEE FOR
INDIRECT BACKING OF KOREAN CONSTRUCTION PROJECTS IN
THE MIDDLE EAST IS GOING VERY WELL. TENTATIVE
COMMITMENTS TOTAL \$85 MILLION, ALL FROM U.S. BANKS
AND INCLUDING \$15 MILLION THAT WILL BE TAKEN BY FNCB.
WHILE SHERMAN ANTICIPATES THERE WILL BE SOME SLIPPAGE
ON THE FEBRUARY 29 COMPLETION DATE FINANCE MINISTER
KIM YONG-HWAN PROMISED PRESIDENT PARK HE WOULD MEET,
SHERMAN BELIEVES TOTAL SUBSCRIPTIONS ARE LIKELY TO
EXCEED THE \$100 MILLION TARGET, POSSIBLY BY QUITE A
BIT.

2. THE SYNDICATION GUARANTEE WILL BE A BACKUP OF A
KOREA EXCHANGE BANK (KEB) GUARANTEE. AS THE PROPOSAL
IS DRAWN UP, KOREAN CONTRACTORS WILL ARRANGE FOR PERFORMANCE
BID BONDS, PERFORMANCE BONDS AND ADVANCE PAYMENTS
GUARANTEES WITH LOCAL, E.G. SAUDI ARABIAN, BANKS WHICH WILL
BE DIRECTLY BACKED BY A KEB GUARANTEE AND ONLY INDIRECTLY BACKED
BY THE SYNDICATION GUARANTEE. IN ITS PRACTICAL CONSEQUENCES,
WERE KEB ACTUALLY TO CALL ON THE SYNDICATION GUARANTEE IT
WOULD BE VIEWED AS SIMILAR TO A KEB DEFAULT ON A LOAN AND THUS IS
HIGHLY IMPROBABLE. IN A SENSE, THE GUARANTEE IN BANKERS' VIEW
CARRIES EVEN LESS RISK THAN A LOAN TO KEB SINCE CONSTRUCTION
ACTIVITIES IN THE MIDDLE EAST COULD WELL CONTINUE IN
CIRCUMSTANCES WHICH MIGHT RESULT IN A KEB DEFAULT OF
LOANS, E.G., AN OUTBREAK OF HOSTILITIES IN KOREA.

3. THE ROKG HAS PLACED A VERY HIGH PRIORITY ON OBTAINING
THIS BACKUP GUARANTEE FROM FOREIGN BANKS AS A MEANS
OF PROMOTING KOREAN CONSTRUCTION ACTIVITIES IN THE
MIDDLE EAST. AS DISCUSSED IN REF MESSAGES, GROWTH OF
KOREAN OVERSEAS CONSTRUCTION ACTIVITIES IN THE PAST
YEAR, PRIMARILY IN THE MIDDLE EAST, HAS BEEN PHENOMENAL
WITH THE VALUE OF CONTRACTS AWARDED KOREAN CONTRACTORS
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RISE FROM \$261 MILLION IN 1974 TO \$829 MILLION IN
1975. THE INSUFFICIENT ACCESS OF KOREAN CONTRACTORS
TO THE KIND OF FINANCIAL BACKING NECESSARY TO POST
PERFORMANCE GUARANTEES FOR LARGE PROJECTS HAS BEEN
CONSIDERED A MAJOR OBSTACLE TO EVEN MORE RAPID DEVELOPMENT
OF THIS ACTIVITY. THE REAL PURPOSE OF OBTAINING
THE SYNDICATION GUARANTEE IS TO DEMONSTRATE KEB'S AND
KOREA'S STANDING WITH THE INTERNATIONAL BANKING COMMUNITY.

THIS DEMONSTRATION TOGETHER WITH A RELIABLE PERFORMANCE RECORD BY KOREAN CONTRACTORS IN MAJOR PROJECTS IS EXPECTED TO OBTAIN THE NEED FOR FURTHER STANDBY GUARANTEES FROM INTERNATIONAL BANKS IN THE FUTURE.

4. CONTRACTS COVERED BY THE SYNDICATION GUARANTEE MUST BE UNDERTAKEN IN THE FIRST YEAR WITH COVERAGE EXTENDING FOR A MAXIMUM OF THREE YEARS BEYOND THAT. THE RETURN TO THE BANKS PARTICIPATING IN THE SYNDICATION GUARANTEE IS EXPECTED TO AVERAGE 2.4 PERCENT.

5. SHERMAN NOTED THAT FNCB CHECKED OUT THE RECORD OF KOREAN CONTRACTORS IN THE MIDDLE EAST AND FOUND A GENERAL CONSENSUS THAT THE KOREAN FIRMS HAVE WORKED OUT MOST OF THE KINKS AND ARE GENERALLY WELL-REGARDED. ROKG MINISTER OF NATIONAL CONSTRUCTION KIM CHAE-KYU ANNOUNCED YESTERDAY THAT NEW CONTRACTS AWARDED KOREAN FIRMS IN 1976 TOTAL ONLY \$48 MILLION TO DATE, BUT THAT KOREAN FIRMS ARE CONFIDENT THEY HAVE SUBMITTED WINNING BIDS FOR A TOTAL OF ALMOST \$1.3 BILLION IN CONTRACTS TO BE AWARDED SHORTLY. IF CORRECT, THESE CONTRACTS ALONE WOULD PUT KOREA OVER THE TOP ON ITS TARGET OF \$1.2 BILLION FOR NEW CONTRACTS IN 1976. IN THE SAME SPEECH MINISTER KIM STATED HE NOW EXPECTS KOREA TO TRIPLE THE ORIGINAL 1976 GOAL FOR NEW CONTRACTS.

COMMENT: FOR THE MOMENT, THE EMBASSY IS INCLINED TO TAKE MINISTER KIM'S REMARKS WITH A HEALTHY GRAIN OF SALT. EVEN BY KOREAN STANDARDS, EXPANSION AT THAT PACE WOULD RAISE SERIOUS QUESTIONS AS TO WHETHER KOREAN CONTRACTORS ARE GETTING OVER-EXTENDED. RECENTLY-PASSED LEGISLATION DESCRIBED IN THE REF MESSAGES WAS INTENDED TO GUARANTEE THAT WOULD NOT HAPPEN. IF OVERSEAS CONSTRUCTION LIMITED OFFICIAL USE

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ACTIVITIES REALLY CAN BE EXPANDED THAT RAPIDLY IT WOULD HAVE IMPORTANT IMPLICATIONS FOR THE BALANCE OF PAYMENTS OUTLOOK IN THE RELATIVELY NEAR TERM. USING THE CURRENT "RULE OF THUMB" ESTIMATE OF FOREIGN EXCHANGE EARNINGS EQUAL TO 33 PERCENT OF THE VALUE OF CONTRACTS LAGGED OVER THREE YEARS, A 1976 CONTRACT TOTAL OF \$3 TO \$4 BILLION COULD CONCEIVABLY GENERATE RECEIPTS IN EXCESS OF \$1 BILLION OVER THE NEXT THREE YEARS FROM 1976 CONTRACTS ALONE.
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